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SUBJECT: SERBIA: 2008 BUDGET SENT TO PARLIAMENT

REF: Belgrade 1545

Summary

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11. On November 12, the Serbian Government adopted a 2008 budget with a 9.9% increase over 2007, with revenues of \$12.02 billion, expenditures of \$12.3 billion and deficit of \$280 million. The consolidated fiscal deficit is projected to improve in 2008 to 0.6% of GDP, mostly by keeping increases in public sector wages at the rate of inflation. Economists and IMF complained that the budget is expansionary and advised running a surplus. The IMF also questioned the government's projections. Two thirds of budget expenditures will go into public sector wages, pensions, the health and unemployment funds, and to local government. End Summary.

Draft Budget 2008 \$12 Billion - Up 9.9% Over 2007  
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12. The Serbian Government adopted a draft 2008 budget on November 12 and sent it to the Parliament for adoption by December 15. With the approval of the budget by the government, an advisor to the speaker of parliament assured econoff that passage in the parliament would be forthcoming. The budget stipulates total revenues of \$12.02 billion and total expenditures of \$12.30 billion resulting in a deficit of \$280 million. Both revenues and expenditures are projected to be up by 9.9% nominally compared to the 2007 budget (2008 inflation is projected at 6%). The budget deficit as a percentage of GDP remains unchanged at 0.5%.

Budget: Not an Economically Optimal Compromise  
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13. Finance Minister Cvetkovic stated on November 18 that the budget provides, "financial support to government policies. The budget is not a result of daily political compromises but political compromises necessary for approaching the EU. A much better budget which would be based on economic principles could not be implemented in these socio-economic conditions." Janko Guzjan, State Secretary in Finance Ministry in charge of budget drafting told a visiting Treasury official on November 15 that fiscal policy was weak, and that the political coalition was not strong enough to push ahead with significant reforms.

Reactions: Budget Should Be More Restrictive  
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14. Central Bank Governor Jelasic commented publicly on November 16

that as a result of fiscal policies, monetary policy would continue to be restrictive, which could cause further appreciation of the dinar against euro. Belgrade Economic Faculty Professor Jurij Bajec told a visiting Treasury official on November 16 that the budget would look much different if there were no elections coming. The budget deficit, although small, was a bad signal, indicating that the government welcomed spending above earnings - a surplus would be better for psychological reasons. Stojan Stamenkovic of the Economic Institute claimed in discussions with the same Treasury official that government projections of macroeconomic figures were not consistent and if the government continued on the projected fiscal policy path for 2008-2010 the level of real investment would drop to zero. Pavle Petrovic, an economist from the USAID sponsored FREN think-tank, told econoff on November 15 that there was pressure from economists and the IMF to run a surplus to make space for private investment, but it was hard to sell the idea of fiscal restrictiveness when the government was still receiving privatization revenues.

#### IMF: Government Calculations Too Rosy

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15. According to the IMF's calculations the 2008 Serbian budget deficit will be around \$940 mil. (1.8% of GDP) instead of government projected \$280 mil. The IMF suggested a restrictive fiscal policy with a surplus in the 2008 budget of 1% of GDP, through control of public sector wages, cuts in the capital budget, subsidies and other current spending. In November 15 discussions with a visiting Treasury official, IMF Resident Representative Hirschhofer highlighted the conclusions of the early November IMF consultations in Belgrade that the presently unbalanced domestic policy mix of loose fiscal, tight monetary, and slow-moving structural reform would further raise concerns over external stability and would

BELGRADE 00001595 002 OF 002

dampen growth prospects.

#### Tax Revenues Projected to Grow 12-17% in 2008

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16. Over 93% of government revenues are projected to come from tax revenues, with almost half (48.7%) from the VAT. The next largest sources of revenues are excise taxes (17.4%) followed by the income tax (11.3%), customs fees (9.6%) and finally corporate profit tax (5.3%). Tax revenues are projected to increase between 12-17% in 2008, except for the corporate profit tax, which is projected to increase by almost 25%. Hirschhofer told the Embassy that in his discussions with the Finance Ministry the government "found" \$200 mil. of additional revenue in the last week before the budget's approval. The Ministry did not provide Hirschhofer with a basis for their revised projections.

#### Two Thirds For Pensions, Wages and Transfers

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17. Almost 90% of projected 2008 expenditures are current expenditures, while just 10% are for capital investment. More than one third of total budget expenditures (35.6%) are transfers, mostly to the pension and health funds (25.3%) and to local government (10.3%). The second largest expenditure category is wages for public sector employees (27%). Social allowances for the poor (children, veterans, severance for redundant workers) are projected to reach 10.2% of expenditures, while subsidies to companies (mostly agriculture and railroad) should reach 6% of expenditures. Procurement of goods and services should reach 7% of total expenditures.

18. The 2008 increase in expenditures of 9.9% over 2007 comes mostly from an increase in the public wage bill of 15.6% and an increase in transfers to the pension and health funds and to other levels of government of 14.8%. Despite the fact that Finance Minister promised in June, after the adoption of 2007 budget, that the public wage bill would be frozen as of November 2007, this was later changed to a policy of "keeping wages unchanged in real terms in 2008" i.e. an increase in wages in line with inflation.

Comment

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¶9. The Serbian Government faces a difficult situation - on one hand being accused by economic experts of a loose fiscal policy and generous wage policy. On the other hand the government faces strikes by public sector workers demanding higher wages (court staff, teachers, and the announcement of a state administrators strike). The government is soft enough in the current political atmosphere to resort to further wage increases to maintain political support, and just rich enough to do so. However, the problem for Serbia is that almost every year is a (pre)election year and the growing budgets pile on top of each other. Thus, the 2007 budget was (nominally) 33% higher than the originally planned 2006 budget, while 2008 budget adds an additional 10% increase to this already high spending. It is likely that this pattern will continue since the current government/Ministry of Finance has demonstrated an unwillingness to be tough in facing wage demands. Thus the issue is how long this can last without triggering balance of payments problems, as we have reported reftel. End Comment.

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